

Office of Chief Counsel
Internal Revenue Service

memorandum

CC:SB:5:STP:TL-N-6439-00
DLZoss

date: January 3, 2001

to: Bryan Stiernagle, Revenue Agent
District Technical Coordinator

from: Associate Area Counsel
St. Paul, Minnesota

subject: **Failure to File & Failure to Pay on Stat. Notices of Deficiency**

This is written in response to your request dated November 3, 2000. We have reviewed the materials submitted with your request. We assume for purposes of this memorandum that an I.R.C. § 6020(b) return has been prepared for the taxpayer preliminarily to the issuance of the statutory notices described in your request.¹ We also assume that the statutory notices described in your request are being issued more than five months, but less than 50 months, after the due date for the return for the taxable year(s) at issue. Finally, we assume that the penalties under both I.R.C. § 6651(a)(1) and I.R.C. § 6651(a)(2) apply at the time the statutory notice is being prepared.

Under I.R.C. § 6751(a), notice of deficiency penalty determinations must include a correct computation of the penalty. Thus, because any notice of deficiency to which this memorandum applies will be determining that both penalties are applicable, any computation schedule attached to the notice of deficiency for I.R.C. § 6651(a)(1) should use the 22.5 percent rate for computing the penalty under that section. At the same time, because the 50 month period relevant to computation of the I.R.C. § 6651(a)(2) penalty will not have expired, it will not be possible at issuance to compute the actual amount of the I.R.C. § 6651(a)(2) penalty.

Your inquiry suggests that you propose using the 25 percent amount for I.R.C. § 6651(a)(1) for all notices of deficiency

¹We attach hereto a copy of Chief Counsel Notice N(35)000-169, dated November 16, 1999, and recent Chief Counsel Service Center Advice, TL-N-6441-00, which discuss the application of I.R.C. § 6651(a)(2) to such returns for your review.

including those in which the I.R.C. § 6651(a)(2) penalty is also determined to apply. This approach is advocated to deal with the theoretical prospect that the Court would ultimately determine that I.R.C. § 6651(a)(1) applied but that I.R.C. § 6651(a)(2) did not for any reason, e.g. that reasonable cause existed for a failure to pay but not for a failure to file.

As noted above, we do not believe the approach you advocate is in accord with I.R.C. § 6751(a). Even if such an approach were otherwise permissible, we do not believe that such an approach is necessary if the determination language set out below is used. Because I.R.C. § 6651(c) computationally coordinates these two provisions, we believe the following determination language would allow computation of the I.R.C. § 6651(a)(1) penalty at a 25 percent rate, without the need for either an alternative position stated in the notice of deficiency or affirmative allegations in respondent's answer, in the event the contingency noted above arose. Finally, from a practical and administrative standpoint, it makes more sense to us to tailor routine procedures to a majority, rather than to a minority, of cases. Indeed, we believe that the occurrence of such contingency would be rare, requiring a recomputation of the I.R.C. § 6651(a)(1) penalty at a 25 percent rate in only a small minority of cases. On the other hand, the alternative approach you advocate of always computing the I.R.C. § 6651(a)(1) addition to tax at the 25 percent rate for all notices of deficiency would ultimately require a revised, and otherwise unnecessary, recomputation prior to assessment in the vast majority of cases.

Based on the foregoing comments, we recommend that notices of deficiency issued for years where taxpayers have not filed returns reflect determinations with respect to I.R.C. §§ 6651(a)(1) and 6651(a)(2) using explanations, as follows:

Since you did not file your return for the tax year ended _____, within the time prescribed by law, and you did not show reasonable cause, a penalty of 5 percent a month is added to the tax for each month, or fraction thereof, for which your return was late as provided by I.R.C. § 6651(a)(1). This penalty cannot exceed 25 percent and will be reduced by the amount of the penalty provided by I.R.C. § 6651(a)(2) for any month, or fraction thereof, in which both I.R.C. § 6651(a)(1) and I.R.C. § 6651(a)(2) apply.

In addition, since you did not pay the income

tax you owed for the tax year ended _____,
within the time prescribed by law, and did
not show that such failure was due to
reasonable cause, a penalty of 0.5 percent a
month is added to the tax for each month, or
fraction thereof, for which your return was
late as provided by I.R.C. § 6651(a)(2).
This penalty cannot exceed 25 percent.

Further, the notice of deficiency may include a dollar
amount for the penalty under I.R.C. § 6651(a)(2), provided that
the following additional language is referenced with an asterisk
next to the I.R.C. § 6651(a)(2) dollar amount:

This amount reflects the addition to tax
under I.R.C. § 6651(a)(2) through the date of
this notice. The addition to tax will
continue to accrue from the date due of the
return at a rate of 0.5 percent for each
month, or fraction thereof, of nonpayment,
not exceeding 25 percent.

Should you have any questions, please contact the
undersigned at (651) 290-3473 ext. 242.

GERALD W. LELAND
Associate Area Counsel (SBSE)

By: /s/ David L. Zoss
DAVID L. ZOSS
Senior Attorney (SBSE)

cc: St. Paul Appeals